

Message Text

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ACTION EA-09

INFO OCT-01 ISO-00 FEA-01 ERDA-05 AID-05 CEA-01 CIAE-00

CIEP-01 COME-00 DODE-00 EB-07 FPC-01 H-02 INR-07

INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04 USIA-06

SAM-01 OES-06 SP-02 SS-15 STR-04 TRSE-00 /092 W

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P 300832Z APR 76

FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC PRIORITY 4179

C O N F I D E N T I A L JAKARTA 5732

E.O. 11652: GDS

RAGS: ENGR, EINV, ID

SUBJECT: USG TAXATION OF INCOME FROM OVERSEAS OPERATIONS OF U.S.
OIL COMPANIES

REF: JAKARTA 5647

1. SUMMARY: GOI HAS DECIDED HIRE WASHINGTON LAW FIRM OF ROGERS AND WELLS TO REPRESENT THEM IN PRODUCTION SHARING TAX PROBLEM. MINISTER SADLI HAS RAISED WITH AMBASSADOR QUESTIONS OF MOTIVE BEHIND IRS RULING AND POSSIBLE APPLICATION DOUBLE TAXATION TREATY. END SUMMARY.

2. MINISTER OF MINES SADLI SUMMONED AMBASSADOR APRIL 30 FOR FURTHER DISCUSSION IRS RULING ON INCOME TAX CREDIT FOR U.S. COMPANIES WITH PRODUCTION SHARING CONTRACTS. SADLI SAID MATTER WAS OCCUPYING MAJOR ATTENTION OF GOI AND HE WANTED FURTHER GUIDANCE ON HOW PROBLEM SHOULD BE APPROACHED.

3. FIRST QUESTION WAS WHY RULING HAD COME AT THIS TIME. AMBASSADOR EXPLAINED THAT RULING WAS NATURAL OUTCOME OF QUESTION PUT BY MOBIL TO IRS AND TIMING HAD NO SIGNIFICANCE. (SADLI OBVIOUSLY REFLECTED SUSPICION WHICH HAS BEEN VOICED HERE THAT RULING MAY BE USG RESPONSE TO CURRENT INDONESIAN
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PRESSURES FOR MORE REVENUE FROM OIL COMPANIES.)

4. AMBASSADOR STRESSED THAT AS FAR AS HE KNEW, PROBLEM WAS ONE RELATING SOLELY TO INTERPRETATION OF PRODUCTION SHARING CONTRACT IN LIGHT OF U.S. TAX LAW. UNDER SUCH LAW IF PAYMENT CANNOT BE DEMONSTRATED TO BE CREDITABLE TAX, IT IS ASSUMED TO BE ROYALTY. U.S. AUTHORITIES ARE SYMPATHETIC TO DISCUSSION OF WAYS IN WHICH PRODUCTION SHARING ARRANGEMENTS CAN BE MADE COMPATIBLE WITH U.S. TAX LAWS.

5. SADLI SAID THAT INDONESIA HAD HIRED FIRM OF ROGERS AND WELLS BUT WAS NOT YET QUITE SURE ABOUT HOW TO PROCEED. AMBASSADOR SAID NEXT STEP WOULD APPEAR TO BE DISCUSSION BETWEEN INDONESIAN REPRESENTATIVES AND U.S. COMPANIES ON HOW BEST TO APPROACH IRS. ACCORDING EMBASSY'S INFORMATION FROM WASHINGTON, GOI REPRESENTATIVES AND ATTORNEYS COULD PARTICIPATE IN MEETING BETWEEN U.S. COMPANIES AND U.S. TAX AUTHORITIES.

6. SADLI SAID IT HAD STILL NOT BEEN DECIDED WHETHER GOZALI WOULD GO TO U.S. (REFTEL). (GOZALI CALLED PETROLEUM OFFICER EARLIER TO SAY GOI HAD HEARD FROM COMMONS OF NATOMAS THAT TREASURY ORDER WOULD BE ISSUED NEXT WEEK AND IT WAS "TOO LATE" FOR COMPANY OR GOI INTERVENTION.)

7. SADLI ALSO SAID THAT IF TAX RULING COULD NOT BE REVERSED "NATURAL PROGRESSION OF EVENTS" MIGHT LEAD U.S. COMPANIES TO WITHDRAW IN WHICH CASE GOI WOULD NEED TO COMPENSATE THEM AT "BOOK VALUE" AND TURN OVER THEIR RIGHTS TO EUROPEAN FIRMS.

8. SADLI MENTIONED THAT U.S. AND BRITAIN HAD DOUBLE TAXATION AGREEMENT WHICH COVERED TAXES OF NORTH SEA OIL. HE ASKED WHETHER INDONESIA MIGHT HAVE SIMILAR ARRANGEMENT AND WHETHER THIS MIGHT HELP RESOLVE CURRENT PROBLEM. AMBASSADOR MENTIONED THAT TAX TREATY WAS VIRTUALLY AGREED TO EXCEPT FOR LANGUAGE RELATING TO DEFINITION OF INDONESIA WHICH HAD NO RELATIONSHIP TO TAX QUESTION. AMBASSADOR SUGGESTED THAT IF HE COULD GET MINISTER OF JUSTICE TO RELAX INSISTENCE ON PRECISE LANGUAGE, TAX AGREEMENT WOULD BE CONFIDENTIAL

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BE POSSIBLE. SADLI COMMENTED THAT THIS WOULD BE DIFFICULT; MINISTER OF JUSTICE HAS BEEN PUSHING ARCHIPELAGO THEORY FOR 15 YEARS.

9. ACTION REQUESTED: REGARDLESS OF LAST NEGATIVE STATEMENT, COULD DEPARTMENT ADVISE US WHETHER TAX TREATY MIGHT BE WAY OUT OF CURRENT PROBLEM OF TAX CREDIT FOR PRODUCTION SHARING PARTNERS.

NEWSOM

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